

Accounting for Impairment of Assets : An External Reporting Perspective

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Abstract

Accounting for impairment of assets has emerged in recent years as a major issue of importance in corporate financial accounting and reporting internationally. The leading accounting standard-setters around the world have issued pronouncements prescribing principles and procedures for recognizing, measuring, and disclosing information about impairment of assets. In India, the ICAI has promulgated AS 28 to address asset impairments. The main objective of these pronouncements is to ensure that an asset is not recorded in the balance sheet at an amount that is higher than the value of the future economic benefits the asset is expected to generate. Asset impairment refers to loss of asset value, which may be permanent or transient. An asset is described as impaired when its net book value exceeds the amount that can be recovered from it. Impaired assets should be written down to their recoverable amount. This article explores, from an external reporting perspective, the various conceptual and procedural issues involved in the recognition, measurement and reporting of asset impairment.

Key-Words : Carrying value; Conceptual framework; Disclosure, Fair value; Impairment; Measurement; Recoverable amount; Value-in-use.

Introduction and Background

Accounting for impairment of assets is an issue of growing importance in corporate financial accounting and reporting internationally. The rapid changes in technological, economic, and regulatory conditions have significantly enhanced the susceptibility of assets to an impairment of value. Entities operating particularly in industries with shorter technology cycles are experiencing huge asset impairment very frequently. This has made it imperative for them to adopt a systematic and consistent approach to account for the impairment of their assets. The leading accounting standard-setters around the world have issued pronouncements (e.g., FASB, 2001; IASB, 2004; ICAI, 2002; UK ASB, 2000) prescribing principles and procedures for recognizing, measuring, and disclosing information about asset impairment. The main objective of these pronouncements is to ensure that assets are recorded in the balance sheet at no more than their recoverable amount. Impairment exists when the economic benefits that an asset is expected to generate is less than the amount at which the asset is carried in the balance sheet. The impairment of assets is not a new concept. It has been around for a long time. But the concept has now assumed new dimensions and it is now being applied in a wider context. Increasingly, more and more asset categories are being brought within the purview of impairment accounting.

In a comprehensive value-based system of accounting, impairments are automatically accounted for when asset values are revised at balance sheet date. But that does not happen when historical cost constitutes the basis of measurement of assets. Under the historical cost system of accounting, assets are recorded in the balance sheet at cost minus any accumulated depreciation or amortization. If an asset suffers economic impairment, the depreciated historical

cost of the asset should further be reduced by the amount of impairment loss in order to improve the soundness of the balance sheet. The prudence principle demands this and any violation of this would distort the financial results depicted in the financial statements. But implementing the principle may not always be easy. Entities that have complex asset structures and those that perform complex economic operations are likely to face considerable difficulty in recognizing and measuring asset impairment.

In India, the Institute of Chartered Accountants of India has promulgated AS 28 (ICAI, 2001), which deals comprehensively with impairment of assets. The standard has used International Accounting Standard IAS 36 (IASB, 2004) as its foundation. AS 28 applies to all assets other than inventories, assets from construction contracts, financial assets including investments and deferred tax assets. The recognition, measurement and reporting of these assets are governed by other accounting standards. AS 28 is applicable to all other assets that are carried at cost and to those that are carried at revalued amounts in accordance with other applicable accounting standards. The standard includes requirements for identifying and measuring impairment of assets, recognizing or reversing any resulting impairment losses, and disclosing information on asset impairment. AS 28 has become applicable from April 1, 2004 to all companies that are listed and to those with a turnover of more than Rs.50 crore. With effect from April 1, 2005, the standard becomes applicable to all enterprises notwithstanding their listing status or their turnover. Prior to the promulgation of AS 28, there was a lack of comprehensive guidance about how to determine and measure asset impairment. As a result, the accounting for asset impairment was not consistent. Enterprises in India dealt with asset impairment in the financial statements in a rather perfunctory manner. AS 28 intends to change the scenario. It seeks to transform asset impairment accounting into a regular and systematic exercise India. But implementing the standard is not going to be an easy task. For many entities it will entail a lot of preparatory work.

The aim of this article is to examine the issues involved in the recognition, measurement and reporting of asset impairment in the context of preparation and presentation of external financial statements. It gives particular attention to the recent regulatory actions and regulatory developments in the area of impairment accounting. The rest of the article proceeds as follows. The next section explores the principles and methodologies of asset accounting. In the third section an attempt is made to examine the various aspects of recognition and measurement of impairment. The fourth section deals with recovery of impairment. In the next section attention is focused on the issue of impairment disclosures. The last section concludes the discussion.

Principles and Methodologies of Asset Accounting

Accounting for impairment of assets is the area of asset accounting that deals with the impact of decline in asset value. There are four stages in asset accounting: recognition, measurement, remeasurement and derecognition. Asset accounting begins with the recognition of an item as an asset. Once a decision is taken to the effect that an asset has been created, the next task is to assign a monetary amount to it. This is called initial measurement. The amount at which an asset is measured initially may have to be revised on a subsequent date. This subsequent revision of the carrying amount is described as asset remeasurement. The reduction of the carrying amount of a depreciable asset resulting from the charging of depreciation is not an

asset remeasurement. It is an allocation of cost. Impairment may exist even when assets are properly depreciated based on systematic depreciation accounting principles and rules. When an asset ceases being an asset, it is removed from the books. This is called derecognition. With derecognition the asset accounting cycle is completed.

■ *The Primacy of the Balance Sheet*

Most of the leading accounting standard-setting bodies of the world (eg, Australian ASB, 2004; FASB, 1978, 1980, 1984, 1985, and 2000; IASB, 1989; ICAI, 2000; UK ASB, 1999) have developed concepts statements with a view to strengthening the theoretical foundation for the formulation of accounting standards. The statements are aimed at providing guidance in selecting the events and phenomena to be accounted for, how they should be recognized and measured, and how they should be reported. These concepts statements, usually referred to as the 'conceptual frameworks', are founded on the notion of awarding primacy to the balance sheet. Accordingly, greater emphasis has been placed on preserving the balance sheet's conceptual purity. This means that items that are not genuine assets and liabilities are not included in the balance sheet. The key to this balance sheet model of accounting is the definitions of assets and liabilities. The conceptual frameworks define assets and liabilities independently and these definitions are then used to define the other financial statement elements. The balance sheet model is focused on measuring and reporting the net wealth of the reporting entity, as reflected in its resources and obligations. Under this model, profits and losses result from changes in those assets and liabilities that change the entity's net wealth. This model represents a departure from the traditional accounting model that attaches primacy to the concepts of revenues and expenses. In the revenue/expense-driven accounting model, profit results from matching revenues and expenses and assets and liabilities are simply the residuals of the matching process — the debits and credit balances that remain after the closing of accounts books. The balance sheet model is the converse of this. In this model, the balance sheet carrying amounts are determined first and revenues and expenses become the balancing figures. Under this model, revenues result from increase in assets or decrease in liabilities, while expenses result from increase in liabilities or decrease in assets.

The conceptual frameworks have adopted an economic approach in defining assets and liabilities. Assets are defined in the frameworks in terms of economic resources and liabilities in terms of obligations to transfer those resources. For example, the IASB framework (IASB, 1999) defines assets and liabilities as:

An asset is a resource controlled by the enterprise as a result of past events and from which future economic benefits will flow to the enterprise (paragraph 49a).

A liability is a present obligation of the enterprise, the settlement of which is expected to result in an outflow from the enterprise of resources embodying economic benefits (paragraph 49b).

Because liabilities depend on assets, they also can be treated as secondary. Thus, it is the definition of assets, which, in the ultimate analysis, comes to be regarded as the most fundamental of fundamentals in the balance sheet model of accounting.

As is evident from the definition, assets have three key attributes: future economic benefits, control, and past events. The essence of an asset is its future economic benefits, which are

embedded in its ability to contribute to the entity's net cash inflows. There are various ways in which an asset can contribute to the entity cash flows. Whatever may be the case, if an item is incapable of generating any economic benefits for an entity, it is not an asset of that entity. However, the ability to generate future economic benefits does not of itself give rise to an asset. The control aspect is also very important, the essence of which is that no item can simultaneously be an asset of two entities. An entity must be able to exclude others' access to the future economic benefits of an item in order to be able to treat it as its asset.

According to the third attribute, assets come into being as a result of past events. Unless there is any past event, there cannot be the creation of an asset. Transactions are common examples of past events. Other asset-creating past events include gifts, discoveries and accretions.

Items that do not meet the definition of assets are not assets for accounting purposes. An item that meets the definition qualifies for recognition as an asset if it also satisfies the prescribed asset-recognition criteria. The most important asset-recognition criterion is that there should be high probability that the future economic benefits associated with the asset will flow to the entity. Another recognition criterion is measurement reliability. An asset is not an asset if it cannot be measured at a monetary amount with sufficient reliability.

■ *Asset Measurement Bases*

The choice of an appropriate measurement basis is an issue of crucial significance in asset accounting. There are a variety of measurement bases that can be used to determine the monetary amount at which assets are to be carried in the balance sheet. The most commonly used measurement basis is historical cost. It is considered to be the most objective and verifiable basis of measurement in accounting. An alternative to historical cost measurement is current value measurement, which can assume a variety of forms such as replacement cost, net present value and net realizable value. The net present value, which is based on the concept of discounting, is theoretically superior but it is subject to substantial uncertainty and potential manipulation. There is a hybrid measurement system that uses both historical cost and current value as measurement bases. In fact, generally accepted accounting principles (GAAP) in most jurisdictions require entities to prepare financial statements based on historical cost-dominated hybrid measurement system. Under this approach, some assets, especially the non-financial ones, are measured based on historical cost and some on current value. When an asset is first acquired, it is recognized in the accounts at its actual transaction price. This happens not only in historical cost accounting but also in current value accounting. This is so because at the date of acquisition of the asset cost equals future economic benefits. Measurement differences are encountered when it comes to subsequent restatement of the asset. According to the principle established in the conceptual frameworks, the measurement basis to be employed for each category of assets should be consistent with the measurement objectives in financial reporting. But this principle appears to be somewhat incomplete and vague. In fact, measurement constitutes the weakest segment in the conceptual frameworks.

Although historical cost is regarded as the most objective basis of measurement, historical values often fail to provide relevant, up to date information about entity wealth. Historical cost is not good at coping with rapid changes in market conditions. Moreover, it cannot adequately deal with assets such as, financial derivatives, biological assets and knowledge assets.

The only relevant measurement basis for these assets is current market value. Available indications tend to suggest that accounting standard-setters are increasingly being inclined to require entities to account for more of their balance sheet items at current value. In many of their recently issued pronouncements the standard setters, especially the IASB, have adopted fair value as the preferred basis of measurement. Fair value is defined as 'the price at which an asset or liability could be exchanged in a current transaction between knowledgeable, unrelated willing parties' FASB (2004). A quoted price in an active market is regarded as the best evidence of fair value. If such a price is available, it should be used as the basis of asset measurement. When quoted price is not available, fair value should be estimated using the best information available in the circumstances. One alternative would be to apply the current market price of similar assets. If this approach does not work, fair value should be computed based on any suitable methodology.

In the US, the FASB, after long deliberations, has concluded that fair value is the most relevant measure for certain categories of assets. Most recently, it has issued an exposure draft of a proposed accounting standard, which provides detailed guidance on how to measure fair value in different situations (FASB, 2004).

The concept of 'value to the business' or 'deprival value' has come to be recognized in many quarters as the most appropriate basis of measurement of asset. This measurement concept is based on the notion that an asset can have more than one value depending on whether the entity wishes to retain the asset for use in operations or to sell it immediately. Under this concept, the value of an asset is the lower of the current replacement cost and the recoverable amount, with the latter being defined as the higher of the net realizable value and the value in use or discounted net present value. If an asset is worth replacing, its deprival value should be the replacement cost. If the asset is not worth replacing, its deprival value should be the higher of the net realizable value and the net present value. In deprival value accounting, management intentions are of paramount importance. Whether or not management would replace an asset is the deciding factor in determining how the asset would be valued for balance sheet purposes. This is where deprival accounting differs from fair value accounting. In fair value accounting, management intentions are not taken into consideration. .

As mentioned earlier, asset impairment is automatically accounted for when financial statements are prepared in accordance with the principle of current value accounting. This is because the carrying amount of assets in value-based accounting is determined based on the value prevailing at balance sheet date. But impairment may exist when historical cost constitutes the basis of determination of the carrying amount of assets. Impairment may also exist when assets are revalued from time to time. Since the adoption of a comprehensive value-based accounting is not going to happen immediately, impairment accounting will continue to play a crucial role in preserving the sanctity of the entity balance sheet by ensuring that assets are not overstated beyond the amounts expected to be recovered through use or sale.

Recognition and Measurement of Impairment

Impairment refers to the state of having a condition, which means that something has stopped working properly. Put another way, an impaired object is an object that is unable to perform its normal functions. In the context of asset accounting, impairment refers to value loss, which

can range from mild to profound. Asset value loss can be permanent or transient. An asset is considered value impaired when its economic service potential is diminished. The value impairment may be caused by a variety of factors. According to the principles established in the impairment accounting standards, asset-value loss should be properly accounted for in order to prevent overstatement of profits and net worth. As noted previously, an asset is overstated in the balance sheet when the amount expected to be recovered from the asset is less than the amount at which it is reported. The principle of full, fair and transparent financial reporting requires that assets should neither be overstated nor understated in the balance sheet. To achieve this goal, it is necessary to prepare financial statements based on a coherent and consistent system of current value accounting. But the move towards full current value accounting is still a long-term aim and a great deal of work still has to be done in order to reach this goal. Until a full current value as an asset measurement model is adopted, it has to be ensured that assets at least are not overstated in the balance sheet. That assurance is necessary because overstatement is potentially more damaging than understatement.

A mere reduction in the recoverable amount of an asset may not necessarily give rise to its impairment. For an impairment to exist, the decline in value is to be of such a magnitude as to bring the asset's worth below its book value. An asset may suffer economic impairment suddenly or it may be the result of operation of some continuing adverse forces. Whenever an asset suffers economic impairment — in the sense that its carrying value is not recoverable— an impairment loss should immediately be recognized. The loss that should be recognized is the amount by which the carrying amount of the asset exceeds its recoverable value. The loss should be recognized despite the fact that it is not a realized loss. The new carrying value of the impaired asset should be its recoverable value.

The entity in control of an asset has only two choices available as to the mode of utilization of the asset: selling and using. The entity should sell the asset if the net amount realizable from the sale is greater than the asset's value in use. An asset's value in use is the discounted present value of estimated future cash flows expected to arise from the continuing use of the asset and disposal at the end of its useful life. If this value in use is greater than the asset's net realizable price, the asset should not be sold. Instead, it should be used. The higher of the net selling price and the value in use is termed as the 'recoverable amount'. A major aspect of impairment accounting relates to the determination of this recoverable amount. It may be mentioned in this context that a similar exercise is performed in measuring asset value under deprival value accounting.

If there is an indication that an asset may have impaired, the following steps are taken :

- Determination of selling price;
- Determination of value in use;
- Measurement of recoverable amount;
- Comparing the recoverable amount with the carrying amount.
- Allocation of impairment loss and determination of new carrying amount;
- Revision of future depreciation or amortisation charges; and
- Making adequate disclosures.

■ **Testing Assets for Impairment**

When should an asset be tested for impairment? According to AS 28, an enterprise is required to assess at each balance sheet date whether there is any indication that an asset may be impaired. Testing assets for impairment is required only when impairment indications are present. If impairment indications are not present, no impairment testing is necessary. The International Accounting Standard IAS 36 (IASB, 2004) requires that the recoverable amounts of the following types of intangible assets should be measured annually whether or not there is any indication that they may be impaired (paragraph 10):

- An intangible asset with an indefinite useful life.
- An intangible asset not yet available for use.
- Goodwill acquired in a business combination.

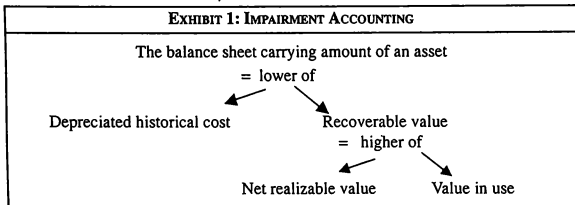
The indicators of asset impairment may be many and varied and they may be internal as well as external. Entities are required to take all possible impairment indicators into consideration while assessing the existence of asset impairments. They have to assess the technological, economic and legal environments in which they are operating and determine whether significant changes in those environments have occurred. It may even be necessary for them to consider value drivers in order to identify asset impairment events. Some of the possible impairment indicators are:

- Decreases in the market value of the asset;
- Material changes in the extent or manner in which the asset is used;
- Changes in physical conditions of the asset;
- Technological obsolescence;
- Negative changes in market, economic and regulatory conditions;
- Loss of a key employee or loss of a major customer;
- Changes in interest rates and rates of inflation;
- Reduction in market price of share below the net asset value (NAV);
- Accumulation of costs significantly greater than the amounts originally estimated; and
- Substantial increases in the operation and maintenance cost of assets

The existence of one or more of these indicators obligates an enterprise to conduct an impairment test. This involves estimating the asset's recoverable amount and comparing that amount against the asset's carrying amount. If the recoverable amount is less than the carrying amount, the carrying amount of the asset should be reduced to its recoverable amount. The reduction in the carrying amount is an impairment loss and that loss should be recognized as an expense in the profit and loss account. But if the asset in question is a previously revalued asset, the loss should be treated as a revaluation decrease.

Once an impairment loss is recognized, the reduced carrying amount forms the basis of computation of future depreciation if the asset is a depreciable asset. If the amount of impairment loss of an asset exceeds the carrying amount of the asset, a liability should be recognized for the excess amount. But before any liability is recognized it has to be ensured that there exists

a present obligation to transfer resources in the future. This, in a nutshell, is what constitutes the framework of accounting for impairment of assets. Exhibit 1 shows how an asset would be carried in the balance sheet based on impairment accounting principles:



If the asset in respect of which an impairment test is being conducted were not a depreciating asset, the phrase 'depreciated historical cost' in the above figure would have to be replaced by the phrase 'historical cost'.

The most difficult aspect of asset-impairment accounting is the estimation of the recoverable amount. As has been mentioned previously, the recoverable amount of an asset is either the amount expected to be recovered from using the asset or the amount to be recovered from selling, whichever is higher. When estimating the recoverable value of an asset, it is better to start with the asset's net selling price. If the amount expected to be realized from sale is greater than the carrying amount, the asset is not impaired and no further action is necessary. It will be necessary to determine the other amount only if the estimated net selling price is less than the carrying amount. In that case the estimation of the other value - the value in use - will be required.

The net selling value (or net realizable value) of an asset is the amount of cash to be expected from selling the asset less cost of realization of cash. This amount can be easily estimated if there is an active secondary market for the asset. It is also possible to arrive at a reasonable estimate of the asset's net realizable value where there is a binding sale agreement in an arm's length transaction. In other cases, reasoned judgements have to be applied in order to estimate the net amount expected to be recovered from selling.

Estimating an asset's value in use involves identifying the future cash flows expected to be derived from the asset and discounting those cash flows to present value. Entities should estimate future cash flows using reasonable and supportable assumptions. They should give consideration to all available evidence and give appropriate weights to factors. AS 28 requires that cash flow projections used in measuring value in use be based on management's most recent financial budgets/forecasts. Such projections should normally cover a period of five years. Cash flow projections beyond this period should be estimated based on forecasts using a steady or declining growth rate (paragraph 26). Any estimated future cash inflows or outflows expected to arise from future restructurings to which an enterprise is not yet committed or from future capital expenditure that will improve or enhance the performance of the asset are to be excluded from future cash flow estimations (paragraph 36).

Discounting future cash flows to present value requires the selection of an appropriate discount rate. According to AS 28, the discount rate should be a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the asset to the extent that the risks are not reflected in the cash flows. It may be mentioned here that the US FASB's approach to computation of value in use is quite different. Under this approach, no discounting is necessary. In its SFAS 142 (FASB 2001), the FASB requires impairment loss recognition if the sum of undiscounted cash flows is below the carrying amount.

■ *Grouping of Assets for Impairment Measurement*

Impairment is assessed on an individual asset basis. But if an asset does not generate cash flows that are independent of the cash inflows of other assets, impairment is to be assessed at a group level. Assets are generally bought and sold individually but, in many cases, they work together to generate benefits. The basis to be adopted for grouping assets may be the entire entity, or a specific plant, division, branch, or a business segment. According to AS 28, if recoverable amount cannot be estimated for an individual asset, it should be estimated for the cash-generating unit (CGU) to which the asset belongs. The standard defines a cash-generating unit as the smallest identifiable group of assets that generates cash inflows from continuing use that are largely independent of the cash inflows from other assets or groups of assets (paragraph 64). CGUs are, in fact, the lowest level from which data for management decision-making can be drawn. When impairment loss is computed at a group level, the loss should be allocated to the assets in the group on a pro rata basis using their relative carrying amount. According to US GAAP (FASB, 2001), the CGU is to be a reporting entity. The UK accounting standard FRS 11 (ASB, 1998) requires large enterprises to identify income-generating units (IGUs) for the purpose of estimating recoverable amount. According to the standard, IGUs should be identified by dividing the total income of the entity into as many largely independent income streams as is reasonably practicable. Each of the identifiable assets and liabilities of the entity should be either attributed or apportioned between IGUs.

■ *Impairment of Goodwill*

Under AS 28, entities are required to test their acquired goodwill for impairment like any other assets. But the difficulty with goodwill is that it does not generate cash flows independently from other assets. Because of this, the impairment assessment of goodwill should be conducted on a CGU basis. Entities first of all are required to allocate goodwill to the CGUs that are expected to benefit from the asset. The allocated goodwill then will form part of the total carrying amount of the CGUs. The impairment of a CGU is then assessed by comparing this carrying value to its recoverable amount. The process of allocation should follow a 'bottom-up' approach. The goodwill is identified with particular CGUs and allocated to them on a consistent and reasonable basis. A 'top-down' approach is used in addition if goodwill cannot be allocated based on this principle. The goodwill is identified with a group of CGUs rather than individual ones. The goodwill forms part of the total carrying amount of the group of CGUs. Where both tests are used, both can give rise to an impairment charge. The bottom-up test determines the impairment of the individual CGU under review, and the top-down test determines the impairment loss for goodwill. The use of the top-down test could result in a CGU being tested for impairment which might otherwise have escaped review had the bottom-up approach been successful in attributing goodwill to the original CGU under review.

The impairment loss is allocated to reduce the carrying amount of the assets of the unit (group of units) in the following order :

- first, to goodwill allocated to the CGU (if any); and
- then to the other assets of the unit on pro-rata basis on the carrying amount of each asset in the unit (AS 28, paragraph 87).

However, the carrying amount of an asset should not be reduced below the highest of:

- its net realizable value (if determinable);
- its value in use (if determinable); and
- zero (paragraph 88).

In the US, the FASB has radically changed its approach to goodwill accounting. This is going to affect significantly the financial results of entities in FASB jurisdictions. The FASB in its accounting standard SFAS 142 (FASB, 2001) has abandoned the traditional amortization approach to account for purchased goodwill. According to this newly promulgated accounting standard, entities will now be required to carry goodwill as an asset without reduction for periodic amortization. Instead of amortizing acquired goodwill, entities will be required to test it for impairment on an annual basis. If impairment exists, the carrying value of goodwill will be reduced. The Canadian standard-setters have framed their new goodwill accounting rules using the FASB new rules as the foundation. The UK ASB in its standard FRS 10 (ASB, 1997) recognizes that, where goodwill has an indefinite life, amortization does not measure any economic reality. The standard gives entities the choice of amortization or systematic testing for impairment. According to the indications available, the IASB is thinking in terms of adoption of FASB's impairment route.

The new impairment approach to goodwill accounting seems more rational than the conventional amortization approach. It is not realistic to assume that goodwill always loses value on a regular and systematic basis. In fact, goodwill, in most case, loses value somewhat irregularly and in varying amounts. If impairment accounting is effectively implemented, it will be able to capture this reality.

■ *Impairment of Corporate Assets*

Corporate assets are assets that contribute to the future cash flows of several CGUs. Examples include assets such as headquarters building, an entity division, information technology equipment and research centers. It is the structure of an entity that determines whether an asset meets the definition of corporate assets for a particular cash-generating unit. Because these assets do not generate separate cash inflows, the recoverable amount of an individual corporate asset cannot be determined unless management has decided to dispose of the asset. The impairment test of corporate assets should be performed using the approach adopted in respect of goodwill. This approach, as has been explained above, is a combination of 'bottom up' and 'top down' tests.

Accounting for Subsequent Recovery of Impairment

Recovery of impairment refers to the reversal of loss of asset value. That reversal may be full or part reversal. If circumstances change, the benefit yielding ability of an asset may improve

enabling the asset to generate more cash flows in the future than previously anticipated. When this happens, all or part of an impairment loss recognized in a prior period should be reversed. If this is not done, an inconsistency will arise. According to AS 28 (paragraph 94), an entity shall assess at each reporting date whether there is any indication that an impairment loss recognized for an asset in prior years may no longer exist or may have decreased. If this is the case, the loss should be reversed and the carrying amount of the asset should be increased. Since impairment reversal is a profit, it should be credited to the profit and loss account. But the increased carrying amount arising from reversal of impairment loss should not exceed the carrying amount that would have been determined had there been no impairment loss recognition in the past. An increase in the carrying amount of an asset above the carrying amount that would have been determined had no impairment loss been recognized in the past is a revaluation. When impairment loss is reversed and the carrying value of the asset is increased, future depreciation or amortization should be computed with reference to this higher carrying amount.

In measuring impairment loss reversal, an entity is required to follow the same approach as is applicable to the identification of impaired assets. The indicators of impairment reversals are similar, but opposite, to those used to identify impairment.

A reversal of an impairment loss for a CGU should be allocated to the unit components on a pro-rata basis. But the rule prohibits reversal of impairment loss for goodwill except when the loss was caused by a specific external event of an unexpected and exceptional nature and a subsequent favourable external event occurs (such as a legal, political, or technological change) that reverses the effect of the earlier event (AS 28, paragraph 108). This restrictive condition has been imposed in order to prevent recognition of internally generated goodwill. It may be pointed out here that internally generated goodwill, while valuable to an entity, is never recognized in the financial statements.

There is one more restriction. In allocating a reversal of impairment for a CGU, the carrying amount of an asset should not be increased above the lower of:

- the recoverable amount of the asset (if determinable); and
- the carrying value of the asset which would have been determined had no impairment loss been recognized for the asset in prior periods (paragraph 107).

The amount of the reversal of the impairment loss that would otherwise have been allocated to the asset should be allocated to the other assets of the unit on a pro-rata basis.

Asset Impairment Disclosures

Disclosures play a vital role in impairment accounting. Accounting for impairment of assets is a complex exercise. The recognition and measurement of impairment involve estimates and judgements. Detailed disclosures are necessary for enabling the users to understand the real financial statement impact of impairment phenomena. Incomplete or inadequate disclosures may impair the users' decision-making ability. AS 28 requires entities to make full disclosure of relevant information relating to impairment. The disclosure requirements fall into three categories: disclosure by class of assets, disclosure by segment, and other disclosures.

■ Disclosure by Class of Assets

Under the standard (paragraph 117), entities are required to disclose, for each class of assets,

detailed information as to (i) the amount of impairment losses recognized in the statement of profit and loss during the period and the line item(s) of the statement of profit and loss in which those impairment losses are included; (ii) the amount of reversals of impairment losses recognized in the statement of profit and loss during the period and the line item(s) of the statement of profit and loss in which those impairment losses are reversed; (iii) the amount of impairment losses recognized directly against revaluation surplus during the period; and (iv) the amount of reversals of impairment losses recognized directly in revaluation surplus during the period.

The information required in paragraph 117 may be presented with other information disclosed for the class of assets. For example, this information may be included in a reconciliation of the carrying amount of fixed assets, at the beginning and end of the period.

■ **Disclosure by Segment**

An entity that reports segment information in accordance with AS 17, should disclose the following for each reportable segment based on an entity's primary reporting format (paragraph 120):

- (a) the amount of impairment losses recognized in the statement of profit or loss and directly against revaluation surplus during the period; and
- (b) the amount of reversals of impairment losses recognized in the statement of profit and loss and directly in revaluation surplus during the period.

■ **Other Disclosures**

If an individual impairment loss (reversal) is material, disclosure is necessary in respect of:

- Events and circumstances resulting in the impairment loss;
- Amount of the loss;
- Individual asset: nature and segment to which it relates;
- Cash generating unit: description, amount of impairment loss (reversal) by class of assets and segment; and
- The bases of computation of recoverable amount.

If impairment losses recognized (reversed) are material in aggregate to the financial statements of the entity as a whole, disclosure is necessary in respect of the main classes of assets affected by impairment losses and the main events and circumstances that led to the recognition (reversal) of impairment losses.

The standard encourages entities to disclose the key assumptions used to determine recoverable amount of assets.

Conclusions

Impairment accounting is aimed at improving the quality of corporate financial reporting. It seeks to bring about improvement in the reliability and transparency of financial reporting through enhancing the soundness of the balance sheet. High-quality financial reporting is needed

to provide for a more efficient allocation of resources in the economy. Investors should be provided with relevant and reliable information, on a timely and regular basis, regarding the reporting entity that is material to their investment decisions. Financial reporting is of high quality if it depicts in a reliable and transparent manner the underlying economic realities of the financial events and phenomena of the reporting entity. But how far impairment accounting will be able to bring about real improvement in the quality of financial reporting depends to a great extent on how effectively the standards are implemented. If the standards are not implemented in their true spirit, the objective of impairment accounting may not be realized. Improper or bad implementation of the standards may even give rise to misleading financial reporting. Implementation of the standards may not be proper if the requirements they set out are not fully complied with or if they are complied with in a 'creative' way.

Entities performing complex economic operations may, at times, experience genuine problems in identifying impaired assets and in assessing the recoverable amounts of the assets identified as impaired. Impairment review may be potentially time-consuming and costly for those entities that have not efficient and effective management information systems. It may be necessary for entities to develop sophisticated business forecasting models to be able to estimate future cash flows of assets in a systematic way.

The recognition and measurement of asset impairments involve subjective judgements. Many have expressed the fear that the subjectivity involved in the recognition and measurement of impairment will provide entities with enough scope to manipulate their financial results. This fear is not unfounded. Managements are in the habit of playing the financial number games. They play the game in the hope of earning financial rewards. In fact, potential financial rewards for playing the game can be substantial. Adequate safeguards are necessary in order to ensure that impairment is not used as a game item. When benefits are perceived, managements may avoid recognizing impairment losses by overestimating future cash flows. At other times, they may be induced to believe that a significant write-off will benefit them. Accordingly, they will underestimate future cash flows. Entities also at times may be induced to record impairment reversals when in fact no reversals do exist.

Impairment accounting seeks to prevent overstatement of assets in the balance sheet. When impairment occurs, assets are written down to the recoverable amount. But if the recoverable amount is higher, assets are not then written up to the recoverable amount. The rule is, therefore, asymmetric. This asymmetry exists because standard-setters are addressing financial reporting issues on a piecemeal basis. If the quality of financial reporting is to be improved, asset recognition and measurement should be based on a coherent and consistent accounting model. The conceptual frameworks the standard setters around the world are currently using as the basis of their standard-setting work appear not to be in good shape. The concepts statements, in many respects, are inadequate and incomplete. In many cases they fail to provide clear-cut answers to accounting problems. Moreover, certain aspects of the conceptual frameworks are inconsistent with others. The frameworks need refinement and updating. . In the USA, the FASB has acknowledged that its conceptual framework has deficiencies and has taken a decision that it should be added to its agenda as a standing item. The IASB has also admitted that its conceptual framework needs improvement and is considering how best to improve it

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